

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



July 15, 2003

Agenda ID #2475
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 99-06-052

This is the draft decision of Administrative Law Judge (ALJ) O'Donnell. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN

Angela K. Minkin, Chief
Administrative Law Judge

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Attachment

Decision **DRAFT DECISION OF ALJ O'DONNELL** (Mailed 7/15/2003)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell
(U 1001 C) for Authority Pursuant to Public
Utilities Code Section 851 to Lease Space to
Affiliates.

Application 99-06-052
(Filed June 30, 1999)

O P I N I O N

1. Summary

Pacific Bell (Pacific) seeks Commission approval, pursuant to Public Utilities Code Section (Section) 851, to lease unused space to its affiliates. Pacific states that the lease arrangements comply with the affiliate transaction rules of this Commission and of the federal government. This portion of the application is unopposed and, therefore, approved. Pacific also asks that it be authorized to transfer a lease of space approved in this opinion to another administrative affiliate performing the same administrative support functions without filing a Section 851 application. We deny this request.

2. Background

In this application, Pacific requests authority to lease space at 26 locations to affiliates performing administrative functions, and at two locations to other affiliates. Pacific also asks that it be allowed to transfer, without filing a Section 851 application, the lease of any of the designated spaces if a different

administrative affiliate subsequently assumes the administrative support functions specified for that space.

Pacific states that the spaces it proposes to lease are currently not necessary for its operations and will not interfere with existing operations. It states that, because the affiliate leases comply with the affiliate transaction rules, the affiliates will not be subsidized by Pacific and the arrangements will not create anti-competitive effects. Some of the leases seek to increase the amount of space that has been previously authorized.

Some proposed leases are intended, in compliance with D.98-07-015, to rectify situations where the affiliate already occupies the space. In such cases, Pacific represents that it has ensured that the billing for the space will comply with the Commission's affiliate transaction rules.

Many of the leases are based on forecasts of future needs by the affiliates. Pacific states that such space will not be reserved for the affiliates. Rather, at the time the affiliate requests to actually occupy the space, Pacific will lease the space only if it is not needed for its own purposes.

On August 6, 1999, the Commission's Office of Ratepayer Advocates (ORA) filed a protest to the application.

On September 9, 1999, a prehearing conference was held. As a result, an Assigned Commissioner's Ruling and Scoping Memo was issued on September 10, 1999. It identified the issues and set a schedule for evidentiary hearings.

By an ALJ ruling dated February 8, 2000, pursuant to an unopposed joint motion of ORA and Pacific filed on January 20, 2000, hearings were cancelled and a schedule was set for filing briefs. Additionally, the prefiled testimony of ORA and Pacific were received into evidence.

Briefs and reply briefs were filed by both ORA and Pacific on March 20, 2000, and April 3, 2000, respectively. No other party filed testimony or briefs.

3. Procedural Background

In Resolution ALJ 176-3019 dated July 8, 1999, the Commission preliminarily categorized this application as ratesetting, and determined that hearings were not necessary. On January 6, 2000, the Commission issued D.00-01-005 confirming the Assigned Commissioner's Ruling and Scoping Memo that determined that hearings were needed. On January 20, 2000, ORA and Pacific filed a joint motion to cancel the evidentiary hearings and permit the parties to address the issues in briefs. ORA and Pacific also requested that their pre-filed testimony be admitted into evidence. The motion was unopposed. On February 8, 2000, the assigned ALJ issued a ruling granting the motion. We confirm the ALJ's ruling.

4. Information Filed With the Application

In accordance with the Commission's direction in D.96-04-045, Pacific has attached exhibits to its application with further detail of the proposed leases as follows:

- Exhibit A Matrix of Affiliate Lease Locations
- Exhibit B Property Management Billing Process
- Exhibit C Excerpt from Affiliate Transactions Policies, Guidelines, and Reporting Requirements
- Excerpt from Corporate Principle 80
- Excerpt from Pacific's May 3, 1999, Annual Report on Significant Utility-Affiliate Transactions
- Affiliate Billing Contract Administrator Guideline
- Exhibit D General Services Agreements between Pacific Bell and

Affiliates for:

SBC Center for Learning, Inc.

SBC Services, Inc.

SBC Operation Inc.

SBC International, Inc.

Pacific Telesis Group

Pacific Bell Directory

Exhibit E Real Estate Management Services Schedule and Real Estate
Management Services Pricing Addendum for:

SBC Center for Learning, Inc.

SBC Services, Inc.

SBC Operation, Inc.

SBC International, Inc.

Pacific Telesis Group

Pacific Bell Directory

Exhibit F Pacific Bell's Balance Sheet and Income Statement

5. The Issues

The Assigned Commissioner's Ruling and Scoping Memo identified the following as the issues to be addressed in this proceeding:

- The pricing of leased space.
- The transfer of the lease to another affiliate if the affiliate assumes the administrative support functions specified for the original lessee.

- Potential consumer and competitive concerns.
- The applicability of the Commission's affiliate transaction rules.

6. The Pricing of Leased Space

Lease Pricing was initially an issue between the parties. However, prior to filing the January 20, 2000 joint motion, ORA and Pacific resolved the issue. They agreed that, with the Commission's approval, year 2000 lease contracts would use updated market studies by building location and thus site-specific lease pricing. No party has opposed this proposal, and this pricing methodology appropriately reflects the value of the leases. Therefore, we will adopt it.

7. The Transfer of the Lease to Another Affiliate if the Affiliate Assumes the Administrative Support Functions Specified for the Original Lessee

Pacific requests authority to transfer, without filing a Section 851 application, the lease of space to a different administrative affiliate which subsequently assumes the administrative support functions specified for that space. If the authority is granted, Pacific could only transfer the leases to other administrative affiliates. Administrative affiliates are defined as those affiliates that provide support services solely to the SBC family of companies. Thus, the leases could not be transferred to non-affiliated companies or to affiliates offering services to entities outside the SBC family of companies. Pacific also proposes to notify the Commission, through its Telecommunications Division, of any subsequent transfers.

A. Positions of Parties**1. Pacific**

Pacific states that, because responsibility for administrative support functions can shift from one administrative affiliate to another, a different administrative affiliate could assume the support functions of the affiliate identified as the original lessee at a particular location. Since the terms and conditions under which the initial lease was approved would remain unchanged, it makes no sense to require Pacific, the Commission, and other parties to devote their limited resources to a new application solely because a different administrative affiliate is assuming the same support functions.

Pacific believes that its request fully complies with Section 851. Pacific states that its request seeks the authorization required by Section 851, and is not an attempt to avoid the authorization, or remove the leased space from Commission jurisdiction.

Pacific contends that pursuant to General Order (GO) 69, it could enter into a revocable license agreement with an affiliate in order to adapt to changing conditions while a Section 851 application is pending. Pacific believes that its request will promote regulatory efficiency by eliminating additional filings for approval of the same property under the same terms and conditions.

2. ORA

ORA contends that Pacific has not demonstrated that its proposal is in the public interest. ORA states that Pacific has failed to show how increasing competition justifies an exemption from Section 851. ORA also states that Pacific has failed to address the competitive effects of its request.

ORA represents that Pacific can enter into revocable licensing agreements pursuant to GO 69 in order to implement organizational changes

without delay. This would mitigate against any delay resulting from the Commission's consideration of a Section 851 application.

ORA states that Pacific has made similar requests in the past. The requests were denied in each case.

B. Discussion

Section 851 provides that no public utility shall lease any part of its property necessary and useful in performing its duties to the public without prior Commission authorization. Every such lease that is not authorized by an order of the Commission is void.

In D.98-07-006, the Commission described the purposes of its Section 851 review process. One purpose is to review the transaction before the transaction is consummated, and to take such action as the public interest requires. Another purpose is to ensure that the transaction is accounted for in conformance with the Commission's requirements. When the transactions are with affiliates, a purpose of the review is to determine whether the transactions may have anti-competitive effects or result in cross subsidization of non-regulated entities.

The current process allows interested parties the opportunity to review the proposed transactions. It also allows all parties due process in having their concerns addressed before the proposed transactions take place. Pacific's proposal would amount to an exemption from review. The proposal does not provide for public notice or review of the proposed transfers. Rather, it would allow Pacific to merely inform the Commission's Telecommunications Division of the transfers.

Implicit in Pacific's proposal is the assumption that subsequent transfers of leases do not require review because nothing has changed. Pacific

misses the point. When such transfers occur, a review is necessary to determine that the new lessee is, in fact, an administrative affiliate performing the same administrative functions. Over time, issues relevant to the review may change due to legal, economic, technical or other factors. Under Pacific's proposal, such issues would not be considered.

Under the current process, future Section 851 applications to transfer leases to other administrative affiliates performing the same administrative functions should proceed expeditiously and efficiently if the transfers are as Pacific claims. If Pacific feels that it is necessary, it can enter into revocable licensing agreements pursuant to GO 69 in order to act more rapidly. Public notice and scrutiny of such leases by the Commission and other parties prior to approval is a critical element of the Commission's public process. Pacific's request would in effect delegate prior review to Pacific without public notice and with only the obligation to inform the Commission of its action. We reject Pacific's proposal.

8. Potential Consumer and Competitive Concerns

Initially, parties raised several concerns regarding Pacific's proposed leases. The concerns were: (1) interference with existing operations or customer service, (2) cross subsidization or anti-competitive effects, and (3) possible use of proposed lease spaces for collocation purposes. After discovery and review, ORA concluded that it had no objections to the proposed leases. No other party offered evidence of adverse effects on consumers or competition. Therefore, we conclude that there are none.

9. The Applicability of the Commission's Affiliate Transaction Rules

Applicability of the affiliate transaction rules was initially an issue between the parties. However, prior to filing the January 20, 2000 joint motion, ORA and Pacific resolved the issue. They have agreed that Pacific will follow the Commission's affiliate transaction rules. In particular, the leases will be priced at the higher of the fair market value or the fully allocated cost plus 10%. No party has opposed this agreement. We will adopt it.

10. Additional Filing Requirements

A. Positions of Parties

1. ORA

ORA proposes that Pacific be required in subsequent Section 851 lease space filings to provide two lists regarding central offices. The first is a list of all central office spaces with the addresses. The second is a list of all central office locations where collocation space is exhausted or approaching exhaustion. ORA states that such lists would alleviate concerns regarding collocation at proposed lease sites.

2. Pacific

Pacific opposes ORA's proposal. Pacific states that it is already required to identify proposed leases of space at central offices in its applications. Pacific also believes that such a requirement would inject collocation issues into every Section 851 application Pacific files.

B. Discussion

We will not adopt ORA's proposal because the current requirements are sufficient. ORA and other parties can pursue such issues through discovery. We note, however, that in this application Pacific claims to be concerned with the

efficiency of the review process. Pacific would do well to consider voluntarily providing the information requested in ORA's proposal, as well as other information routinely sought by other parties in Section 851 proceedings. Such action by Pacific may alleviate parties' concerns about the applications. This, in turn, may eliminate protests to the applications, or reduce the need for discovery and, therefore, speed the review process.

11. Leases Without Section 851 Approval

A. Background

In A.97-12-021, Pacific sought approval of a lease of space to an affiliate. The lease had been implemented without prior Section 851 approval.

On January 26, 1998 and February 2, 1998, the assigned ALJ issued rulings directing Pacific to check that there are no other similar leases to affiliates or other entities that require Commission approval for which approval has not been requested or received, and to report the results. Pacific was also directed to explain why it should not be fined under Sections 2107 and 2108 for failure to secure approval of the lease.

On March 2, 1998, Pacific responded to the ALJ rulings. Pacific performed a search of all of its leases and an inventory of its real property. Pacific found one lease that had not received Section 851 approval, and a few situations where the affiliate occupied more than the authorized space. Pacific also found several instances where it anticipated that it would need to seek modification of its Section 851 authority or, additional authority, due to transfer of administrative support functions as approved by D.97-12-087 in A.97-09-027. Pacific represented that it would take immediate action to comply with Section 851.

Pacific also responded that it would be inappropriate to penalize Pacific under Sections 2107 and 2108 for its violations of Section 851 because its violations were very minor inadvertent oversights.

In D.98-07-015, the Commission found that Pacific has made a satisfactory response to the ALJ rulings. The Commission did not penalize Pacific but required it to notify the Director of our Telecommunications Division when it has completed all of the tasks required for full compliance with Section 851 as indicated in its response.

On May 3, 2000, the assigned ALJ issued a ruling requiring, among other things, that Pacific identify each space in this application which is or was occupied without prior Section 851 approval. On May 24, 2000, Pacific responded.

In its response, Pacific identified 25 spaces at 13 locations which were or are occupied without Section 851 approval. Pacific states its inclusion of these spaces in this application is in compliance with D.98-07-015.

One location with two leases, 6375 Clark Avenue, Dublin, is an anomaly. Pacific does not own the property. Rather, it became a lessee of the property in September 1998. At the time that Pacific leased the property, it was already occupied by employees of SBC Operations and one Pacific Telesis Group employee. While Pacific believes that it is unclear whether Section 851 even applies in a case where a utility assumes a lease of property that is already partly occupied by an affiliate, Pacific included the leases to SBC Operations and Pacific Telesis Group at 6375 Clark Avenue, Dublin, in its application.

The remainder of the spaces were the result of an irregularity in Pacific's internal processes that existed prior to Pacific's March 2, 1998 filing. In 1997, payroll changes for employees transferring from one affiliate to another were

handled by Pacific Telesis Shared Services (PTSS), an affiliate of Pacific that had been formed in December 1996. Initially, PTSS handled payroll changes only for non-regulated affiliates in California. The training for the employees handling the payroll changes did not cover Section 851 because it does not apply to non-regulated affiliates. In late 1997, however, this group assumed the payroll change processing function for Pacific in addition to the affiliates. Because the employees had not been trained on the requirements of Section 851, employees of Pacific were transferred to an affiliate in connection with internal reorganizations, and the space occupied by those employees then became space occupied by affiliate employees without Section 851 approval. Pacific changed its internal processes to address this irregularity following its March 2, 1998 filing.

B. Discussion

In D.98-07-015, we determined that Pacific had made a satisfactory response to the ALJ's inquiry into the occupation of space by affiliates without Section 851 approval. No fines were imposed. We directed Pacific to achieve full compliance with Section 851. This filing was made, in part, to comply with D.98-07-015. We will approve the proposed leases.

12. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____.

13. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Jeffrey P. O'Donnell is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. Notice of this application appeared on the Commission's Calendar on July 7, 1999.
2. Pacific has supplied the information required by the Commission for review of the lease agreements.
3. Beginning with year 2000, Pacific's lease contracts will use updated market studies by building location and thus site-specific lease pricing.
4. The proposed lease agreements are unopposed.
5. Pacific's proposal to transfer the lease of space by an administrative affiliate to another administrative affiliate which assumes the support functions specified for the space, without a Section 851 application, would not provide for prior public notice, and review by the Commission and other parties of the proposed transfer.
6. There is no evidence of anti-competitive effects or cross-subsidization of non-regulated entities from the proposed leases.
7. There is no evidence that Pacific's proposed leases of space to affiliates will impair Pacific's ability to serve the public.
8. Pacific will follow the Commission's affiliate transaction rules regarding leases of space to affiliates.

Conclusions of Law

1. Beginning with year 2000, Pacific's lease contracts should use updated market studies by building location and thus site specific-lease pricing.

2. Pacific's proposal to transfer leases when the administrative support functions for the space are assumed by another administrative affiliate, without filing a Section 851 application, should be denied.

3. Pacific's leases to affiliates should comply with the Commission's affiliate transaction rules.

4. Pacific's proposed leases to its affiliates should be approved.

5. No hearings are necessary.

6. This order should be made effective immediately so that the proposed leases can be implemented promptly.

O R D E R

IT IS ORDERED that:

1. Pacific Bell (Pacific) is authorized, pursuant to Public Utilities Code Section 851, to lease the unused space, listed in Attachment A, to its affiliates subject to the terms and conditions set forth below.

2. Pacific's lease contracts shall comply with the Commission's affiliate transaction rules, and shall be site-specific using updated market studies for each location.

3. Pacific's request to transfer the lease of space if a different administrative affiliate subsequently assumes the administrative support functions specified for that space, without filing a Section 851 application, is denied.

4. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.